No. 3091.

IN THE

United States Circuit Court of Appeals

FOR THE NINTH CIRCUIT.

CLARA M. WIGHT and OTIS B. WIGHT (Her Husband), and GERTRUDE M. GREGORY and T. T. C. GREGORY (Her Husband),
Appellants,

vs.

WASHOE COUNTY BANK (a Corporation) et al.,
Appellees.

APPELLANTS' BRIEF

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APPELLANTS' BRIEF.

This action was brought by appellants as stockholders of the Estate of W. O'H. Martin, Inc., to compel the appellee, Washoe County Bank to transfer on its books fifty (50) shares of its stock standing in the name of Harry M. Martin, and also for certain accrued dividends. Suit was brought by these appellants as stockholders for the reason that the Estate Company refused to bring it.

THE FACTS.

W. O'H. Martin died in September, 1901. At the time of his death he was the owner of 300 shares of

the appellee, Washoe County Bank. These shares were distributed to his widow and children and shortly thereafter these heirs formed a corporation known as the Estate of W. O'H. Martin, Inc. The shares of stock were transferred to this corporation and on February 19, 1903, 300 shares stood in the name of the Estate Company and were represented by Certificate No. 106.

Shortly prior to that time Mrs. Martin, who owned seven-twelfths (7/12) of the stock of the Estate Company, spoke to various directors of the bank about having a representative upon its Board of Directors. The evidence is conflicting as to what she said. She says she was informed by them that all she would have to do would be to transfer some stock to Harry M. Martin so that he could appear on the books as a stockholder, but that the Estate Company would not have to part with the ownership of the shares. Harry M. Martin was not a stockholder in the Estate Company. The directors deny these conversations, but they do not deny that they knew that the Estate Company was the owner of these 300 shares prior to the transfer to Harry M. Martin. In any event, on the 9th of February, 1903, Mrs. Martin called at the bank and Mr. George Taylor, who was then assistant cashier and assistant secretary of the bank, accompanied her into the stockholders' room at the bank. There were present: Mrs. Martin, Harry M. Martin, Anne Martin and Mr. Taylor. Mrs. Martin got her safe deposit box in the bank and took out the certificate for the 300 shares. Mr. Taylor then made out two

new certificates, one for 250 shares in the name of the Estate Company, and one for 50 shares in the name of Harry M. Martin. He took these out into the body of the bank and they were signed by Mr. Ward, a vice-president, and Mr. Taylor then brought them back and signed both the 250 share certificate and the 50 share certificate with his own name as assistant secretary. Mrs. Martin then, in the presence of Mr. Taylor, handed the 50 share certificate to her son, Harry M. Martin, and her daughter, Anne Martin, then said it should be at once endorsed and handed back. Harry M. Martin endorsed it and immediately, in the presence of Mr. Taylor, returned it to his mother and she put it back in the safe deposit box of the Estate Company. On the next day Harry M. Martin was appointed a director of the bank to fill a vacancy created by the death of Director Lyman. At that meeting George Taylor was present, recorded the minutes and signed them as assistant secretary. Harry M. Martin remained a director until June, 1905, when he removed to Tonopah and bought 479 shares of the Nye County Mercantile Company. In 1906, Harry M. Martin wrote to Mr. Taylor, who was still assistant cashier, requesting a loan in the sum of $15,000 from the Washoe County Bank and offering as security his 479 shares of the Nye County Mercantile Company.

On October 9, 1906, the board of directors passed a resolution granting the loan to Harry M. Martin, to be secured by the Mercantile Company shares, and Harry M. Martin received the money and delivered to the bank, through Mr. Taylor, the regular form

by which he pledged as security for the loan his shares in the Nye County Mercantile Company. The value of the stock of the Nye County Mercantile Company was, at the time of the making of the loan, from $75,000, to $100,000. Under the agreement by which the Mercantile Company stock was pledged to the bank, the bank had the right, at any time, on non-payment, to sell the stock or to compel the deposit of additional security. The bank, however, never at any time attempted to sell this stock, nor in any manner to collect the amount due from Harry M. Martin.

On January 15, 1909, Mr. Taylor went to Tonopah and secured a renewal note from Harry M. Martin, again secured by a written pledge of the 479 shares of stock.

Up to the year 1909 the checks for the dividends declared upon the stock of the bank were sent to Harry M. Martin. He immediately endorsed them and delivered them or sent them to his mother and she re-endorsed them "Estate of W. O'H. Martin, Inc. by Louise W. Martin, President" and deposited them with the appellee, Washoe County Bank, and they were entered upon the book of the Estate Company as being credited to the corporation. After 1909, however, the checks, instead of being delivered to Mr. Martin, were always delivered to the Estate Company direct. In other words, though the checks were drawn to Harry M. Martin, they were not endorsed by him at all, but were endorsed by Mrs. Martin, "Harry M. Martin, Estate of W. O'H. Martin, Inc., by Louise W. Martin, President."

I.

The Bank Could Not Assert Its Alleged Lien Because It Had Notice That Harry M. Martin Was Not the Real Owner of the Stock.

It is undisputed that this stock has always, since the death of Mr. Martin, Sr., been the property of the W. O'H. Martin Estate. It is likewise undisputed that, *as a matter of fact,* the stock was transferred into the name of Harry M. Martin without consideration and for the sole purpose of qualifying him as a director, and that the certificate made out in his name was immediately, in the office of the bank, and in the presence of Mr. Taylor, its assistant cashier, endorsed by Mr. Martin, and returned to its real owner; that it was always thereafter in the possession of the Estate; that for a certain period of time the checks for dividends were delivered to Mr. Martin, and by him immediately endorsed to the Estate, and by the Estate deposited to its account; that for a period of about two years these checks were delivered to the Estate and by it deposited to its account.

The defense is based upon a by-law of the bank, in effect attempting to give it a lien upon its own stock for debts due from its stockholders. It is, however, undisputed that the loan for which the lien is claimed was in fact made upon the security of other stock pledged by Mr. Martin as collateral.

The evidence, which we maintain shows that the bank had notice, is as follows:

(a) The whole three hundred shares stood upon its books in the name of the Estate Company.

(b) Mrs. Martin, the principal owner of the stock of the Estate Company, spoke to various directors of the bank, informing them that her interests were so large that she did not feel safe without representation upon the board of directors. She says that at least one of them told her, in effect, that she could make her son a stockholder of record, without really parting with any of the stock. It is true that as to this conversation she is disputed; but in any event, there was enough in the circumstances to warrant the belief on the part of the directors that she was not really selling or giving any stock to her son, but only putting it in his name on the books so he could qualify as a director. When she made the actual transfer she told the assistant cashier that it was in pursuance of this prearrangement.

(c) The actual business was transacted with Mr. Taylor, the assistant cashier and secretary of the bank. He cancelled the old certificate and made out new ones —one for fifty shares in the name of Harry Martin, and one for two hundred and fifty shares in the name of the Estate Company. He likewise signed these certificates in his official capacity. At the very time these new certificates were issued in the offices of the bank and in the presence of this same Taylor, the officer who attended to it, Harry Martin endorsed the fifty-share certificate and delivered it to his mother and she put it in the Estate's safe deposit box.

(d) For a certain period of time, dividend checks

were sent to Mr. Martin. However, he always endorsed them over to the Estate and Mrs. Martin then endorsed them "W. O'H. Martin Estate, Inc. by Louise W. Martin, Pres.", and then deposited the checks in this same bank. Beginning in 1909, however, the dividend checks were delivered to Mrs. Martin direct, and were by her endorsed and deposited. The bank book of the Estate Company showed these deposits and what they were for.

(e) The loan for which the lien is claimed was made through Mr. Taylor. Harry Martin wrote to him, asking for the loan, and tendering the stock of the Mercantile Company as security. Mr. Taylor took this up with the directors and the loan was authorized. It was made upon the security of the Mercantile Company stock, and it is inconceivable that at this time, at least, Mr. Taylor could have failed to communicate to the other officers and directors the fact that Mr. Martin was not the real owner of stock of the bank.

(f) At the time the transfer was made, Miss Anne Martin said to her mother: "Mother, you had better have Harry endorse it right away, have it all complete before you put it in the box." This was in the presence of Mr. Taylor.

(g) Mr. Taylor was at the time of the trial still an officer and director of the bank. He was not, however, produced as a witness.

(h) In July, 1909, Mrs. Martin requested the directors to transfer the stock back to the Estate. Not a word was said then about a claim that they had made

the loan in the belief that Harry was the real owner of the stock. On the contrary, Mr. Bender merely said: "Mrs. Martin, I could not transfer it, but if you get two-thirds of the board you can have it transferred."

(i) The loan to Harry Martin was made in October, 1906. At that time the stock of the Mercantile Company was worth several times the amount of the loan. But in the panic of 1907 the Mercantile Company became practically insolvent. Yet, in January, 1909, the bank, without the least attempt to collect from Harry Martin, or any assertion whatever that they had a lien upon the bank stock, took a new note from him, again secured by a pledge agreement of the Mercantile Company stock. We think that their failure to assert their lien at this time shows clearly that they knew that the bank stock did not belong to him.

The Law.

Mr. Taylor was the officer who had charge of the very transaction of the transfer of the fifty shares. He was also the officer through whom the loan was made. Under such circumstances the law presumes that his knowledge was the knowledge of the bank.

Williams v. *Hasshagen,* 166 Cal. 393;
McKenney v. *Ellsworth,* 165 Cal. 326;
Zeis v. *Potter,* 105 Fed. 671;
7 Corpus Juris, 530.

It has also been held that where the cashier has in-

formation sufficient to put him upon inquiry, the bank is bound.

Groff v. *Stitzer,* 75 N. J. Eq. 452, 72 Atl. Rep. 970;
Kissam v. *Anderson,* 145 U. S. 435.

It is well settled that a provision in the by-laws or statutes, giving a corporation a lien on its own stock does not operate against stock owned by anyone but the debtor.

Mechanics Bank v. *Seton,* 1 Pet. 299.

II.

Mr. Taylor Was Acting Within the Scope of His Authority, and Any Knowledge He Had at the Time the Loan Was Made Was the Knowledge of the Bank.

When Harry Martin made the application for the loan, it was to Taylor. He, having knowledge that the bank stock did not belong to Harry, reported on the loan to the directors. Mr. Mapes, the president of the bank, testified:

> "A. We have a loan committee; the directors of the Washoe County Bank is a committee; the majority rules; the cashiers are instructed to make a certain loan, but not to exceed a certain amount; and it had generally been the custom for people making an application for a loan to have them make a statement of the conditions of the individual or corporation; then it is usually acted on by the board, and whoever that report was handed to —that might be handed to me or the cashier, or some of the members of the bank—employees—

but it is always generally acted on by the board.

"MR. PARTRIDGE: Q. When collateral is tendered as security, who investigates the collateral—whose duty is it in the bank to investigate the collateral?

"A. The whole board, or the majority of the board.

"THE COURT: Give that answer again, please.

"A. The committee.

"The duties of the cashier in general terms, and in a few words are: That they are to make small loans and look after the interests of the bank. Now, I don't want to he misconstrued with any question I answered. The cashiers nor the president alone has a right to make very large loans in the Washoe County Bank, but they do make them with the committee, which is the directors of the bank, and a majority rules."

The rule was stated by Judge Shiras, sitting in the Court of Appeals for the Eighth Circuit in the *City of Denver* v. *Sherret,* 88 Fed. 234, as follows:

> "In Thompson on the Law of Corporations (vol. 4, Sec. 5195) the rule is stated to be to the effect that, in order to bind the principal, the notice must be communicated to one whose duty it is 'to act for the principal upon the subject of the notice, or whose duty it is to communicate the information either to the principal or to the agent whose duty it was to act for him with regard to it.' Counsel for the electric company, in the brief submitted, state their view of the rule in the following terms: 'The general rule with reference to the question of notice is that notice to the agent is notice to the principal, if the agent comes to a knowledge of the facts while he is acting for the principal; but this rule is limited by the further rules that notice to the agent, to bind the principal, must be within the scope of the employment,' —and cite in support thereof the cases of the Dis-

tilled Spirits, 11 Wall. 356, and *Rogers* v. *Palmer,* 102 U. S. 263. In the former case it was said that 'the general rule that a principal is bound by the knowledge of his agent is based on the principle of law that it is the agent's duty to communicate the knowledge which he has respecting the subject matter of negotiation, and the presumption that he will perform that duty'; and in the latter case it was held that knowledge obtained by an attorney when conducting a case for a client was imputable to the latter."

The general rule is also laid down by Thompson, in his work on Corporations, Vol. II, Section 1648 (Second Edition) as follows:

"NOTICE TO AGENT—DUTY TO ACT ON OR COMMUNICATE KNOWLEDGE TO PRINCIPAL.—It may be said generally that notice to the officer or agent of a corporation in due course of his employment in respect to a matter within the scope of his authority, or apparent authority, of such character that it becomes his duty to communicate the information to it, is notice to the corporation whether the officer or agent imparts to it such information or not. And this principle is peculiarly applicable to corporations, since the third person can communicate notice to the corporation in no other way than by notifying the agent of the corporation whose duty it is to receive and communicate it. The conclusion is, that notice to an agent in the absence of fraud or collusion with him, when acting for the corporation, must in every case be imputable to the corporation. But where the officer has acquired information in a private capacity, the rules impose no duty upon him to disclose such knowledge, and it will not be imputed to the corporation."

The same principles are enunciated in *Curtice* v. *Crawford County Bank,* 118 Fed. 390, where the facts were very similar to the case at bar. This latter case is cited with approval in *In re Virginia Hardwood Manufacturing Co.,* 139 Fed. 223. A very able review of the authorities is found in the opinion written by the Chief Justice of Alabama in *Birmingham Trust & Savings Co.* v. *Louisiana National Bank,* 13 Southern Rep. 112. We also quote principles as laid down in 2 Thompson on Corporations (Second Edition) Section 1672, as follows:

> "MATTERS WHICH THE OFFICERS OUGHT TO KNOW IMPUTABLE TO THE CORPORATION.—The circumstances which put a corporation upon inquiry as to the rights or equities of a third person, must be the same as those which will put an individual upon inquiry; otherwise the public would be at an enormous disadvantage, not only in dealing with corporations themselves, but in having their rights destroyed where others who are the trustees of such rights deal with corporations. The corporation will be charged with notice of matters affecting the corporation where its officers have knowledge of facts which would put a prudent person in inquiry that would lead to this knowledge. *The law will also impute to a corporation knowledge of facts which its directors ought to know, in the exercise of ordinary diligence in the discharge of their official duties, when the imputation of such knowledge to the corporation is necessary to protect the rights of third persons.* The directors are presumed to know that which it is their duty to know and which they have the means of knowing. Upon this principle, corporations are often charged with responsibility for the frauds of their ministerial officers. Thus, where the cashier of a

national bank, who was also the treasurer of a savings bank, secretly and fraudulently pledged, for the benefit of the national bank, certain securities belonging to the savings bank, and the securities were sold under the contract of pledge and lost to the savings bank, it was held that the savings bank might maintain an action against the national bank for damages for the conversion of the securities, and that the ignorance of the directors of the national bank, of the act of their cashier, was no defense to the action; since if they were indeed ignorant, their ignorance arose from their failure to perform their official duty."

III.

UNDER THE DOCTRINE OF THE MARSHALLING OF ASSETS, A CREDITOR CANNOT ASSERT A LIEN UPON THE PROPERTY OF A THIRD PERSON, WHERE HE HAS BY HIS OWN NEGLIGENCE SUFFERED OTHER PROPERTY, IN WHICH THE THIRD PARTY HAS NO INTEREST, TO BECOME VALUELESS.

It is perfectly apparent from the evidence that in making the loan to Mr. Martin, the bank relied solely upon his personal credit, and upon the stock of the Mercantile Trust Company pledged as security. Under the terms of the collateral agreement, attached to the note, the bank had the right to sell this stock at any time, and thus satisfy the debt. This stock was worth many times the amount of the loan. But instead of collecting its debt, the bank allowed it to run along, until the pledged stock became valueless. Under such circumstances, it has been held in nearly every state, that the loss must fall upon the one whose

negligence was the cause of it and not upon an innocent party. A typical case is *First National Bank* v. *Taylor,* 76 Pac. 425, where the Supreme Court of Kansas says and quotes:

> "The general rule enforced in equity is that where one creditor is secured by mortgage on several pieces of property, while another creditor is secured by a junior mortgage on only a part of the property, the prior creditor, when chargeable with actual notice of the rights of the junior creditor, is bound to exhaust his security on the property not covered by the junior lien, and that he must account to the junior lien holder if he releases his security on, or pays over to the mortgagor, the proceeds of the property not covered by the lien of the junior mortgagee, after actual notice of the junior lien. *Burnham* v. *Citizens' Bank,* 55 Kans. 545, 40 Pac. 912; *McLean* v. *La Fayette Bank* 4 McLean, 430 Fed. Cas. No. 8889; *Dunlap* v. *Dunseth,* 81 Mo. App. 17; *Aldrich* v. *Cooper,* 8 Vesey, 282; *Turner* v. *Flenniken,* 164 Pa. 469, 30 Atl. 486, 44 Am. St. Rep. 624; 2 Jones on Mortgages, sec. 1628."

IV.

The Statute of Limitations Has Long Since Run Against the Original Debt of the Bank, and Harry Martin Could Not Suspend the Running of the Statute so as to Extend the Lien Upon Property Which in Fact Belonged to a Third Party.

The debt, for which the defendant bank claim a lien, was created in October, 1906. The evidence is not clear whether there was a note at that time—but in any event, the statute has long since run. In Janu-

ary, 1909, however, Mr. Martin executed the note and collateral agreement which is in evidence. It is, however, well settled that a debtor cannot toll the statute so as to prolong a lien upon the property of another. A typical case is

Wood v. *Goodfellow,* 43 Cal. 188,

where the Supreme Court of California says:

> "But it is the settled doctrine of this court, as will be seen from the authorities above cited, that when third persons have subsequently acquired interests in the mortgaged property, they may invoke the aid of the statute as against the mortgage, even though the mortgagor, as between himself and the mortgagee, may have waived its protection; and we see no difference in principle between a suspension of the running of the statute resulting from an express waiver, and one caused by his voluntary act in absenting himself from the state. In either case it is the sole act of the mortgagor, performed at a time when he had lost his rightful control over the property, and when other interests had intervened, which ought not to be dependent for their protection on the conduct of the mortgagor. When the mortgagor has parted with his title to the property, and ceased to have any interest therein, those who have succeeded to his rights stand in the same relation to the mortgagee as if they had originally made the mortgage on their own property to secure the debt of the mortgagor. The mortgagor has no interest in the property, nor are they under obligation to pay his debt. Their property, however, is bound as collateral security for its payment, under the mortgage, which is a contract in writing, by which the property is pledged as a security for the debt. The mortgage, in such a case, has the same effect in law as if it had been

originally made, as a separate instrument, by the parties succeeding to the rights of the mortgagor to secure his debt. If A make a mortgage on his property to B to secure a debt owing from C the action to foreclose the mortgage must be brought within four years from the time when the debt became due. The time could not be prolonged by any stipulation between B and C to which A was not privy. But when the four years were about to expire, could C under our law, indefinitely postpone the bar of the statute, and render it nugatory as to A by absenting himself from the state, and ever returning? The argument of the plaintiff's counsel necessarily leads to this result. But we have not, heretofore, so interpreted the statute. On the contrary, we have uniformly held in analogous cases that the mortgage, as contradistinguished from the mortgage debt, in such cases is to be deemed a contract in writing in the sense of the statute, on which the action must be brought within four years from the time when the action would lie, in order to avoid the bar of the statute. If we had any doubt, on reason or authority, whether the rule is proper, it has been too long established in this state to be now disturbed."

That case is mentioned as stating the correct doctrine in *Bassett* v. *Monte Cristo Mining Co.,* 15 Nev. 300, in an opinion written by Judge Beatty.

It is equally well settled that if the debt is barred by the statute, a lien cannot be foreclosed.

Ewell v. *Daggs,* 108 U. S. 143; 27 L. Ed. 682.

V.

The opinion of the learned Judge of the District Court, in the last analysis, is based upon the proposition that there is no showing that Mr. Taylor was

aware of what was happening right there before him, or heard the conversation that was carried on in his presence. We submit that:

1. There is a strong presumption that a person hears a conversation at which he is present.

2. If he did not hear or see what was happening, it would have been easy enough for the bank to have produced him.

3. It is undisputed that he was told that the shares were being transferred to make Mr. Martin a director, in pursuance of a previous arrangement—and it is inconceivable that he was right there in the room, and did not see Mr. Martin endorse the certificate and deliver it to his mother. Having seen this, it was his duty, inasmuch as he knew Mr. Martin was to be a director, to make inquiry as to the reason of the transfer. But, of course, he knew all the circumstances.

We respectfully submit that the decree should be reversed.

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